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Valuation of Intangible Assets: Should Brand Equity Be Accounted for on the Balance Sheet?

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for on the Balance Sheet?***

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Honors Thesis
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Valuation of Intangible Assets: Should Brand Equity Be Accounted for on the Balance Sheet?

Abstract

Brand valuation has become a commonplace tool for assessing company performance related to marketing and promotions of businesses. However, current U.S. and international accounting standards inhibit the recording of brands as assets on financial statements due to their intangible nature. This paper discusses the importance of understanding the contribution that brands provide to companies and outlines the potential options for reporting any associated intangible assets on financial statements. I suggest that additional reports should be included alongside currently required financial statements to record brand value separately from the other statements. The intangible brand assets should not be placed as a line item on the balance sheet due to the ambiguity involved in valuing them.

1.0 Introduction

Brands have been used for thousands of years to differentiate products from other competitors' products on the market. A painter signing his/her name is an act of branding. A farmer who marks his/her livestock has branded it in order to distinguish it from the animals owned by other farmers. The Greek letters used and worn by fraternities and sororities is another form of identification. By branding these items, a painter, farmer, fraternity brother and marketer are all interested in creating awareness about and loyalty to their products and services.

Modern day branding began to take hold in the 1950s. As the quality of products began to rise across many industries, leading companies, such as Procter and Gamble, General Foods and Unilever began to see intense competition. To combat this issue, many companies began to develop stronger and more creative marketing campaigns to combat the changes in competition of the market. As a result, marketers found new ways to make their products different and stand out from others in the market. One means of doing so was to develop the corporate brand and create customer loyalty. Over time, the branding efforts and ideas of these industry leaders began to seep into marketing across most industries and competitors¹.

Today, branding is everywhere. It is estimated that an average western consumer is exposed to over 3,000 brand-related messages per day². The market is so saturated with brand names and trademarks now that there is a concern that it is becoming too much and too confusing for consumers. Sorting through the clutter of marketing messages can be daunting and overwhelming. But still, branding is a necessary tool for companies to display how they are different and special from their competitors.

In a Forbes article, "Why Brand Building Is Important," Scott Goodson writes, "Brands outlive product cycles.... No branding, no differentiation. No differentiation, no long-term profitability. People don't have relationships with products, they are loyal to brands."³ Brand strength often runs parallel to the success of a company. Consumers latch onto a brand they feel

comfortable and familiar with, one that deviates slightly from other similar products in some way. As a result of this loyalty, customers are more likely to purchase from their favorite brands than from other brands.

Apple has mastered this idea. Consumers line up to buy their new products (Apple Watch, iPad, iPhone) even before all information about the products has been provided to the public. Apple has created a brand where consumers trust that the products released by the company will be of the highest quality and worth the money. In the current market, Apple is able to easily convince consumers that they have a need for a product Apple is selling; consumers trust that Apple knows them enough to suggest good products. For Apple and many other brands, trust contributes to consumers' loyalty and desire to return for future purchases.

Branding is incredibly important to our society today. Many companies rely on it for their success. However, current accounting procedures fail to respect the value brands contribute. This paper will explore further the importance of branding and the necessity of accounting for it within companies' financial statements.

1 "How Brands Were Born: A Brief History of Modern Marketing" M. Arons, 2011.

2 "How Brands Were Born: A Brief History of Modern Marketing" M. Arons, 2011.

3 "Why Brand Building Is Important" S. Goodson, 2012.

2.0 Definitions

Assets: A present economic resource that the entity has a right or other access to that others do not have. They are expected to provide future cash flows.

Brand: The marketing practice of assigning a name, symbol and/or design to a product or service to identify and differentiate it from others in the market. It is an intangible asset (or liability) that affects future cash flows.

Brand Equity (Brand Power): The collective value of a brand as perceived by *consumers*. It is the amount consumers are willing to pay above a product's worth to receive the value of the brand. It is measured by its strength to compete and its future sustainability. Brand equity is measured based on characteristics in familiarity, loyalty, promotion, staff satisfaction and corporate reputation⁴. Lego is currently the most equitable brand⁵.

Brand Value: The internal value of a brand developed by the company. It includes all of the research and resources used to build and develop the brand. Brand value is the benefits generated by the brand minus any costs of acquiring and owning the brand, so brand value equals tangible brand attributes plus brand equity minus price of the attributes. See Appendix 10.4 for a comprehensive look at how brand values are calculated by Brand Finance to prepare the Global 50: The World's Most Value Brands report. Using this measure, Apple is currently the most valuable brand.

Brand Valuation: The assessment by financial analysts and marketers of the value of a brand, which takes into account various factors including the power of a brand and the brand's growth potential.

Brand Strength Index (BSI): A benchmarking tool used to compare the strengths of brands.

Using the Brand Strength Index model, Brand strength comprises three parts: financial, security/risk and brand equity⁶.

Goodwill: An asset representing the future economic benefits arising from other assets acquired in a business combination or an acquisition by an entity that is not individually identified or separately recognized. It is the unidentifiable difference between the purchase price of a company and the value of the sum of all assets minus liabilities purchased.

Intangible Assets: Assets (not including financial assets) that lack physical, tangible substance.

Intellectual Property: Intangible assets either internally created or purchased from an external source that are owned by a company and legally protected against use without consent by outside parties. These include patents, trademarks, copyrights and trade secrets.

Liabilities: A present economic obligation for which the entity is the obligor.

Threshold Effect: A trademark or advertisement for a product or service must be viewed a certain number of times by customers to reach a certain level where sales will begin to increase.

4 "Brand Power – Definition" Brand Finance, 2015.

5 "Apple rated world's most valuable brand and Lego most powerful" C. McEleny, 2015.

6 "BSI (Brand Strength Index) – Definition" Brand Finance, 2015.

3.0 Current Accounting Standards for Brand Valuation

3.1 GAAP: US Accounting Standards for Brand Recognition

Internally created intangible assets are not recognized as assets under US GAAP.

Internally generated intangibles' value cannot be properly and fairly determined, so under GAAP, they are not to be placed on the balance sheet.

Exceptions arise in relation to expensing research and development costs. For brand valuation, this includes the research and development necessary to create the brand and trademark. Expenses would also include advertising costs necessary to promote the brand to the general public⁷.

But, these standards cause a problem when faced with famous brands, such as Apple. A brand like Apple cannot and should not capitalize its brand under current standards. Apple is worth billions of dollars in addition to what its balance sheet reports, attributable to the strong brand that has been built to support the company. But, because its brand has been created internally, and is unlikely to be sold any time soon, Apple's (and many other similarly famous brands) brand value will not be accounted for in any of its financial statements in the near future.

Acquired brands are a different story, however. They can be given a value based on the amount they are sold or purchased for on the open market. Acquired brands are recognized as goodwill to the purchasing company – they are the “extra” amount paid above and beyond the balance sheet value of the company. Once a company is sold, goodwill can be measured, as book value and market value can be compared to derive a value for goodwill.

A brand recorded on the books of an acquirer are kept at historical costs – the cost for which the brand was purchased; they cannot be revalued. So, hypothetically, if McDonald's were to acquire In-N-Out Burger and expand the brand throughout the world, the value of the In-N-Out Burger brand value would remain the same on the financial sheets as when it was acquired.

The increase in market brand value would be ignored, again, as a result of the difficulty of determining internally created value.

There is an exception to the rule of no revaluation of internally generated assets. The exception occurs in the case of goodwill impairment on assets with indefinite lives, such as most brands. Impairment occurs when the carrying value of goodwill exceeds the fair value. Goodwill impairment tests and resulting accounting procedures attempt to write down the value of goodwill on the financial statements to reduce its value, if it appears the value is inflated. They test to evaluate whether goodwill (and the brand) has been negatively affected by such factors as reduced brand power, the economy, and a range of others and mark it down accordingly to prevent goodwill from reflecting inflated numbers. Assessing fair value for brands is difficult, as they are not regularly sold on the market. However, the fair values of brands can be determined using comparable brands' values on the market and estimates from consulting firms, such as Brand Finance. These numbers can help estimate goodwill impairment.

Unfortunately, GAAP does not currently permit companies to report increases in brand value once brands have been acquired and booked at initial costs. There is only a means to devalue a declining or over-inflated brand value. This enables accountants to remain conservative in making estimates.

Many 10-K reports reflect on the value of a company's brand(s), especially for companies that have a strong focus on brand development. Companies often report on the ways in which they have matured internally generated brands, improved upon externally purchased brands and how they intend to acquire more brands to extend the company's brand power. But, this behavior only appears in companies where strong branding practices are a part of the corporate culture, for CEOs who have worked diligently to stress the importance and impact of well-known brands. For other brands, little to nothing is mentioned in the financial statements or in press releases to the public. Because reporting on brand value is not a requirement (and in

internally generated brands' cases, not allowed), many companies are not acknowledging its importance within financial statements.

The marketing field has recognized the validity of branding for decades. But, only in recent years has the financial world, including Wall Street, begun to recognize the value of brands and study the long-term implications that strong brands can have on the financial markets. In turn, financial analysts have begun to perform more studies on stock performance as it relates to brand strength and are beginning to find ways to use the analyses to make smart investment decisions. As investors learn to utilize trends in brands, it will become necessary that accountants provide reports documenting and quantifying changes in brand value. It is the job of accountants to provide reliable and helpful reports for investors to get a transparent look at companies in order to make the best possible investment decisions. Brand value should be made apparent and obvious to the public so that they may make the best possible investment decisions for themselves. Right now, because accountants are not providing that level of detail with regard to brands, there is an obvious gap in financial statements and reports.

3.2 IFRS: International Accounting for Brand Recognition

The same rules as GAAP generally apply under IFRS. Under IFRS, “brands, mastheads, publishing titles, customer lists and items similar in substance that are internally generated should not be recognised as assets.”⁸ [IAS 38.63]

Under IFRS, development costs are capitalized, instead of expensed. However, advertising costs are expenses when they are incurred.

Under IFRS, revaluation to fair value is allowable for intangible assets (production quotas, fishing licenses, taxi licenses), except goodwill. Revaluation is performed only when reference to an active market is possible⁹. [IAS 38.75] For intangible assets, active markets that may act as references for revaluation are extremely uncommon; therefore, the revaluation model is rarely used for intangibles. Instead, as under GAAP, intangibles, including goodwill, after

initial recognition, are most often carried at cost less any accumulated amortization (for assets with finite lives) and impairment losses.

4.0 Significance of Brand Valuation

4.1 Why is Branding Significant?

A brand is the intangible reputation that a company holds among its customers. Brands help customers know what they are going to get when they buy a branded product or service. A brand helps customers to create expectations about the quality of a company. It helps to accumulate and advertise the attributes of a given company. A simple Trademark image, such as golden arches or an apple with a bite out of it, should give customers a very good starting point for creating expectations about any associated services or products. A brand gives a company personality.

Brands foster loyalty among consumers. People are generally willing to pay more when they perceive a brand to be consistent and of an established quality. For example, teenagers are more likely to shop at stores that they have heard of, such as Forever 21 and H&M or even Goodwill than stores not synonymous with clothing, such as Wal-Mart or Target. Both have clothes, so it is all about the mindset of loyalty to specific brands and the expectations about what consumers will and should get for their money. Similarly, consumers are more likely to spend more on a Mercedes than a Ford, no matter the model. Consumers generally expect Mercedes to be more expensive and more stylish than Ford automobiles, and therefore, are more likely to be willing to spend more to buy and invest in a Mercedes, income permitting.

Most of the trademarks in the following image should be easily recognizable. They represent well-known brands. The following chart nicely displays the values many company are

7 "US GAAP versus IFRS: The basics" Ernst & Young, 2011.

8 "IAS 38 – Intangible Assets" Deloitte, 2015.

9 "IAS 38 – Intangible Assets" Deloitte, 2015.

trying to present through the use of certain colors. An understanding of the significance of branding to the business world is pertinent to understanding why the accounting profession must start taking it into account.



Famous Brand Logos¹⁰

The McDonald's brand represents inexpensive food, a family friendly environment, and consistent products. No matter the location around the world, consumers generally know what to expect when they walk into a McDonald's store. The Apple logo triggers an expectation of user-friendliness, excellent customer service and innovative technology. Toyota is associated with creating safe and family-friendly "mom" cars. Enron, on the other hand, is marked by scandal and corruption; it has an adverse brand. For McDonald's, Apple and Toyota, their brands represent an asset; they add value to the company. For Enron, a significant brand in related to the

accounting profession, its brand has become a liability, as many have been discouraged from wanting to associate with the company after the Enron scandal.

Then there is Nike. Nike's brand acts as both an asset and liability. On the one hand, the Nike Swoosh represents revolutionary shoe design and sports paraphernalia, superior value, celebrity association and athleticism; all are an asset to the company. On the other hand, some consumers still associate Nike with horrific overseas labor and sweatshop conditions, a liability to the company. Depending on the consumer, the meaning of the Nike brand can vary drastically. Many companies face similar scandals. The fate of the companies' image relies on how they spin stories and use the positive perspectives of their brand to counteract the liability-creating aspects.

It is important to assess brands' values and attach numeric values to those assets to understand and compare the overall market's perception of brands and the connected companies. Branding is linked to longevity of a company. A company with a better brand identity is more likely to gain customers and grow. As a result, it is important for investors to be aware of the value of companies' brands so that they may make appropriate long-term investment decisions. It is important that investors have all of the information necessary to understand the position of a company in the marketplace, which should include consumers' perceptions of the brand.

The concept of branding is here to stay. Most in business support the idea of branding. It seems to be a hot topic right now. There has been a significant push for increased brand awareness in the last couple of decades. Branding allows companies to create an identity and establish themselves in the marketplace. Brand value is an important asset in business and must be sufficiently acknowledged by accountants.

4.2 What is the Significance of Branding to Accounting?

As stated above, branding provides a value to companies beyond the tangible assets held by companies. It entices (or deters) consumers to purchase certain goods and services. For

example, many iPhone users purchase their phones because they trust the quality of the Apple brand. This value that goes beyond the value of the physical assets held by companies is invaluable, especially for such famous brands as Apple, McDonalds, Coca-Cola, Wal-Mart and Google.

Brand value is not currently recorded on the balance sheet or in any financial statements. It is left to financial analysts, marketers and economists to assess. However, this is problematic for investors. It fails to fairly present companies' financials to the public. A (hypothetical) company may have the same assets as Apple, but without the same brand awareness in the marketplace. Blindly looking at the financial statements of each, investors would not know the difference; a sensible investor would have to be aware that the Apple name differentiates Apple from the other similar company. It is the responsibility of accountants and corporate executives to make the public aware of the status of a company in a way that allows the public to compare companies' worth. Currently, financial statements do not represent differences in brand values, such as that of Apple and its hypothetical equal-asset counterpart. It is important that the accounting profession at least considers the implications of its current standards and contemplates a change to the way brands are recorded.

Financial markets have, similarly, disregarded branding as an indicator of investment value due to the intangible nature of brands – CFOs and analysts have a hard time monetizing them and, therefore, disregard them. However, Credit Suisse changed the game when it reported, “Companies that focus on brand building consistently generate outsize, long-term growth, profitability and return.”¹¹ Credit Suisse gave validity to the idea of brands having value and insinuated that the longevity associated with brand growth was a reason to trust and invest in a company. It gave investors a reason to start looking at brand equity and value to make

investment decisions. With this shift in the economy, accountants must consider making a shift to their own policies regarding brands.

4.3 The Difficulty of Translating Brands to Accounting

Valuing brands is a difficult task. Calculating an accurate dollar amount to assign to a brand in order to record its value on financial statements presents several problems. Brands are intangible. So, they are not sold or bought for a definitive amount. They have no market value until they are sold, when the market value becomes whatever arbitrary amount someone is willing to pay to purchase the brand. In many instances, the price paid for a brand in the market may not equate to what it is actually worth. For example, Apple may see a benefit to buying a small start-up technology company that does not want to sell. In that case, Apple, may be able to buy the company by paying more money than the brand is worth because it has the resources and may see a potential future benefit. Apple has the money, so why not spend a little extra, risk it and see how the start-up grows? If an acquisition fails, Apple's success in other areas can cushion the loss. In this case, for Apple to invest in the brand, Apple may pay more than the brand is worth; it can afford to be wrong regarding acquiring a company. The purchase price of the acquired brand may not be a good indicator of the brand's value in this example.

Additionally, the business world is getting better at valuing brands. However, brand estimates are still just that, estimates. There still remain discrepancies in how brand values should be calculated. Depending on the source, Apple in 2014 was valued at \$124 billion or \$118 billion¹². While this difference may not technically be a significant amount for Apple, it is still a difference of \$6 billion. Similarly, in 2007, Google's brand equity estimates ranged from \$17 billion to \$66 billion¹³.

Even if accountants were to account for brand value on financial statements, their estimates could still be incorrect. There is a good chance they would unfairly represent

companies' statements and financial stability. Accounting for brands leaves too much leeway for accountants based on the existing deviations in brand value estimates being presented now. To accurately present brand values per accounting standards, the profession would have to create a solid and definite method for valuing brands.

Additionally, in accounting, goodwill and intangible assets created internally are not recognized until an asset is sold. For many "famous" brands, such as Apple, Google and McDonalds, it is unlikely that they will sell in the years to come, and therefore, will be unable to realize the value of their brands on any reports in the near future. These brands will most likely continue to accumulate brand equity and value in the coming years and will fail to record any gains or losses on financial statements. As a result, it is difficult to track the financial progress of these brands over time and to evaluate trends. To properly account for brands, exceptions in accounting treatment standards would have to be made to accommodate the internally created nature of brands.

On the other hand, companies that do a lot of acquiring are at an advantage. They are able to recognize the value of the brands they acquire through goodwill. For example, when Disney acquired Marvel and Pixar, it was able to recognize those companies' values. Marvel was acquired for about \$4 billion¹⁴ and Pixar for \$7.4 billion¹⁵. Both companies became an asset on Disney's financial statements. Unfortunately, brands of divisions created within Disney (such as brands associated with the theme parks, hotels, trademarks, etc.), are not recognized as assets. The "Disney" brand is not recognized as an asset because it was internally created and will likely never be sold. One solution to this for companies under current accounting standards may be to create subsidiaries that can, essentially, "purchase" and "sell" brands to and from the parent company. This approach would enable the brands to be accounted for in the financial statements. However, this method raises an ethical question: is the brand truly being sold or it is just being

transferred to a subsidiary to recognize value? Can a company time its purchases and sales to manipulate the books? Would companies set selling prices at certain levels to affect what is reflected on financial statements, regardless of the brands' actual worth?

Along the same lines, many subsidiary and distinct product line brands are assets to the parent company and should be recognized as such. The iPhone, iPad, iPod and Apple Watch brands all add value to Apple. Similarly, Johnson & Johnson and its subsidiaries own the following brands: Tylenol, Neutrogena, Aveeno, Band-Aid and Listerine¹⁶. The Johnson & Johnson name does not add nearly as much value as the brand names of its products. It is important that these product line brands' values be consolidated to measure the value of the entirety of the parent company. It is important that accounting standards provide a concise way to consolidate and compare companies' overall values to the marketplace.

The accounting profession must do a reevaluation of current standards. Currently, there is no way for investors, consumers and analysts to accurately compare companies' brands across companies and industries. If the profession can create a uniform system for valuing brands, it would accomplish two objectives. It would provide confidence to the business world that branding is relevant and should be taken seriously. And, it would allow investors to accurately monitor and evaluate the state of the market and companies within it – the whole purpose behind accounting, in the first place.

10 "Famous Brand Logos" Famous Brands Limited, 2015.

11 "Great Brands Make Great Investments" A. Adamson, 2010.

12 "The value of a brand: Apple and Google top \$100 billion" I. Kottasova, 2014.

13 "Measuring the Financial Value of Brand Equity" J. Anderson, 2011.

14 "Disney to Acquire Marvel Entertainment" Marvel, 2009.

15 "Disney Agrees to Acquire Pixar in a \$7.4 Billion Deal" L. Holson, 2006.

16 "Johnson & Johnson Fact Sheet", 2013.

5.0 Assessing Brand Value - Company Analysis

5.1 Apple Inc.

Apple has the greatest brand value in the world. It essentially relies on its reputation to sustain its business. Its brand value is estimated at \$124.2 billion for 2014 (see Appendix 10.3) and \$128.3 billion for 2015 (see Appendix 10.5). However, these numbers are not reflected on Apple's financial statements.

Apple recognizes about \$230 billion in total assets (Appendix 10.5). Assets consisted of current assets; long-term securities; property, plant and equipment, Goodwill (not including internally acquired brands), acquired intangible assets and other assets. Goodwill consisted of about \$4.6 billion, compared to the estimated \$124.2 billion attributed to brand value. It is evident that the brand value is not considered in the goodwill calculation.

Additionally, Apple's brand value increased by 23% from 2014 to 2015 (Appendix 10.5). This change indicates the potential for great fluctuations in brand value over time, something not currently being reflected on the financial statements, even with acquired brands. It also indicates that brand value fluctuations can be difficult to predict. Even a company like Apple can improve greatly within a year and increase its competitive standing among competitors.

However, brand value change is a relative scale among companies within the economy and markets. Apple's brand value increased by about \$4 billion, which was a 23% increase for that company. However, Google's brand value increased by only 12% in the same years, yet that equated to about a \$20 billion increase in value for Google. Does that mean Google is growing faster? Does that mean Apple is hitting a plateau on brand growth? Does it actually mean nothing? Only time will tell.

Also, like many famous brands (Google, Coca-Cola, Microsoft), Apple is unlikely to sell its brand any time soon. Under accounting standards, Apple will indefinitely fail to record its

brand as an asset on the company's balance sheet. For companies like Apple, where brand value is such a contributing factor to the company's success, its financial statements fail to properly present the value of the company using current standards.

Apple does acquire other companies and, as a result, recognizes those acquisitions as goodwill. But, its internally generated brand is nowhere to be found by investors on its statements.

6.0 Options For Treatment of Brands By the Accounting Profession

There are three options for treating internally generated brands on the financial statements that would maintain efficiency, effectiveness and user friendliness. The three options are outlined below. These options assume that external acquisitions of brands continue to be treated as they are now, as goodwill to the purchasing company.

It is the duty of the FASB and IASB to determine which means of accounting makes the most sense and is the most reliable for the purposes of the financial statements.

6.1 Recognize Brands on the Balance Sheet

The most explicit way to account for brands would be to value them at inception and record them on the balance sheet. Every year, brands would be revalued and balance sheet values would be adjusted to account for any increases or decreases in value, assuming that it is efficient and cost effective to do so.

Creating a line item to capitalize brands would make their value transparent to investors and other financial statement users. In doing so, brand value would remain separate from other line items, so users would still be able to easily distinguish brand assets from other assets.

This approach would be beneficial because it would provide support for marketers. It would provide validity to the theory of brand valuation. It would show that the accounting

profession, FASB and business world stand behind the concepts presented by brand researchers. In addition, it would provide reassurance for investors and finance professionals currently unsure of the impact of brand value on stock performance. The inclusion of brand value would encourage financial statement users to use brand values to help make judgments. By requiring the inclusion of brand value on financial statements, FASB and IASB would highlight the issue of brand value and encourage further research, and they would be making a significant political move in the business world.

However, there are a few foreseeable problems with this approach. For one, internally generated intangible assets have traditionally been left off the balance sheet because they can be closely linked to tangible assets. In these cases, the fear is that assets may be double-counted – costs that go into developing intangible assets are already counted as tangible assets – and it is often very difficult to isolate that portion that has not yet been counted. For example, the quality of inventory sold may contribute to customers' perceptions of the brand's quality; expenses to train employees may contribute to stellar customer service and, in turn, more positive views of the brand; and, similarly, improved office and building maintenance would provide employees and customers with a more inviting and enjoyable experience while working (employees) and when visiting stores (customers), which would cause all involved to view the company and brand more positively. All of these things (inventory, training expenses and buildings) are already reflected on the financial statements and potentially contribute to the brand's value. So, to add the brand's value to the balance sheet without backing out the contributing assets and expenses would be to double count many of these factors.

In addition, assessments of brand value have proven to be inconsistent among assessors, almost appearing to be arbitrary. Forbes estimated Apple's brand value to be \$124.2 billion in

2014, while Business Insider reported Apple's brand value to be \$118.9 billion¹⁷. This difference of \$5.3 billion represents a significant disparity in valuing brands by experts.

Unfortunately, due to the intangible nature of brands, valuing them accurately is difficult and experts may not all use the exact same measures to calculate values. In this situation, there is currently no "right" way to calculate the dollar amount of a brand. There are no financial transactions involved with brand growth that can be tracked and there is no evidence of cash flows, making it even more difficult to put a dollar amount to brand values. Assessors must make assumptions and come to conclusions based on those judgments. As a result, it would be difficult to accurately and fairly present brand values on balance sheets, since measures for calculating their values would be inconsistent.

One solution would be to assign one brand assessment firm the task of valuing all brands. Either FASB, audit firms or companies would be responsible for purchasing reports done to assess companies' brand values from the firm. That way, the system for measuring brand value would be uniform across all companies. This, however, may be too daunting for one firm, such as Brand Finance Plc (the world's leading brand valuation consultancy), who would not only have to assess the top firms, but all firms.

Instead, FASB could work with brand valuation consultancy firms to create a standard set of criteria for accountants and companies to estimate brand value. These standards would deter accountants from inflating brand value on the balance sheet. As long as reported balance sheet values followed the set standards for accounting for brand value and proper professional judgment is used, this approach should not be problematic. However, like everything in accounting, estimates are estimates and valuation will never be perfect.

¹⁷ "The 20 Most Valuable Brands In The World" L. O'Reilly, 2014.

Additionally, however, there is a question of whether to use brand value or brand equity on the balance sheet. The two are different. Brand value is determined using the royalty relief method, which is calculated as brand strength x brand 'royalty rate' x forecasted brand revenues (see Appendix 10.4). However, brand equity (brand power) is consumers' perception of a brand and the value consumers give to it. Apple has the greatest brand value in the world. Lego has the greatest brand equity. The question, then, becomes: should brand value or brand equity be used to value the brand on the balance sheet. Brand value would be useful to financial statement users because it would indicate internal strength of a given brand, where the company is headed in the future, and the investment management has made in improving the brand. On the other hand, brand equity would be useful to statement users, as it would indicate how other shareholders and the market view the company and brand. Brand equity would be more beneficial for indicating future fluctuations in stock performance, signaling whether or not investing in the company is a good decision. Both provide useful information, but cannot both be effectively included in the financial statements.

In addition, by adding brand value to the balance sheet, many firms would see an intense jump in overall value and assets. Tax implications may follow. Also, a jump in value for many powerful firms could discourage start-up firms and create a barrier to entry within the economy and industries due to the intimidation of leading brands. For example, it would highlight even further the near-monopoly that Apple holds over the tech industry.

6.2 Continue to Ignore Brand Value in the Financial Statements

Another option is to keep the standards the way they have always been – to ignore brand values. The current rules ignore the ambiguity of brand valuation and leave valuation to economists, financial analysts and marketers. The accounting system seems to work fine now. Most internally generated intangibles are treated the same way (they are left off the balance

sheet). Treating brands the same way as other intangibles would keep consistency in rule making and minimize confusion for financial statement users.

An informed investor should do his/her own research to see how a brand is perceived by the general public and by industry professionals and how that should predictably affect stock performance, anyway. For example, an up-and-coming tech company may not have strong brand value or equity, yet be highly regarded in the technology industry. Investors should pay more attention to the factors that contribute to brand value growth than to overall brand value displayed as a sizeable asset. Good investors should be more concerned with estimating the potential for brand growth than in brand value at a single given point in time. As a result, the addition of brand value on financial statements could cause more of a hindrance and distraction than help.

Under this approach, if a company has a genuine interest in recognizing brand value on its financial statements, accountants could suggest that they create a subsidiary or secondary company that could “purchase” brands from the parent company and recognize goodwill, much like an acquisition. This purchase would not appear on consolidated financial statements, but would allow brand values to appear on subsidiaries’ individual statements and deliver the desired information about the brands to the public. Unfortunately, this approach would be deemed unethical and an illegal practice rather quickly. There is no 3rd party involved in such a purchase, so parents and their subsidiaries would have the power to set the price of their brands at any arbitrary price; then, the other would purchase it at that price to significantly influence and affect what is reflected on financial statements as the brand values. There is a lot of room for manipulating the books with this approach.

Finally, if internally generated brands are not recognized under this method because they are unidentifiable, acquired brand values should also be kept to a minimum. Consistent with

current standards, brands acquired should be kept at historical costs, unless assessed for impairment.

6.3 Disclose Brand Value in Footnotes or in a Separate Document

A compromise between recognizing brands on the balance sheet and not recording them at all would be to require a report of brand values on the annual reports of companies, separate from the balance sheet. Companies would designate a value to their brands; then, auditors would check the procedures used to value the brands. It would be required that the 10-K provided a section outlining the procedures used to value the brand and give the brand value estimate. The brand value calculation would be available for any interested reader of the financial statement, but it would not be included in the consolidated balance sheet.

In addition, the report would include expectations for and causes of future brand growth or regression. It would outline the ways in which the company is or is not working to improve upon its brand. This supplemental information would provide readers with an understanding of the company's views on branding and a means to comprehend the brand's value.

7.0 How Should Branding Be Treated By Accountants?

The third option (disclosure of brand value in footnotes or in a separate report) should be implemented. With the changing business landscape and a greater emphasis on brand value, it is important that brand be noted somewhere on the financial statements so the public can view its value. But, the vagueness, unpredictability and judgment involved in valuing a brand are too great to allow it to be included explicitly on the balance sheet. Therefore, financial accounting standards should be adjusted to require brand values to be noted in their own separate section within the financial statements.

While brand valuation standards are not a great priority of accountants currently, the accounting profession must make it a priority. Branding has become important to other segments of business (marketing, management, finance). One role of accountants in today's society is to assist in creating fairly presented financial statements to the general public by providing as much information as possible (while keeping things such as trade secrets private). It is also accountants' duty to help management operate as efficiently, effectively and ethically as possible. Part of helping management to present fair statements to the public is to understand and provide useful and necessary information according to the market. While branding is an intangible asset and does not directly relate to cash flows, it is directly important to financial statement users. It is pertinent that accounting standards reflect these users' needs.

But first, discussions need to be had and accounting standards need to be created regarding valuing brands. That way, there can be a general understanding of how brands should be valued. Then, as long as company managers and accountants follow these standards, the public will know that the values assigned to the brands are in the right ballpark based on calculations that have been done in a consistent manner across all brands.

8.0 Next Steps For The Profession

8.1 Enabling Change in the Profession and to Standards

Current standards are stubborn. Because so much thought was put into creating them initially, the process to change them is daunting. It will take commitment by the accounting profession and FASB to make changes.

The first step is to make brand valuation an important issue. Accountants must start talking with non-accountants to assess and understand the level of significance placed on brands by the rest of the business world. Brand valuation has been gaining a lot of traction in the

business world lately; accounting should parallel that trend. Once professionals start talking, they will be able to discuss alternatives for accounting treatment of brands and begin to propose necessary changes.

8.2 Questions for Further Study

A question for further study is whether brand equity varies geographically and demographically. For example, Dunkin' Donuts is well known on the East Coast of the United States. Meanwhile, in the Western states, there are very few Dunkin' stores. Brand recognition in the West is almost non-existent. Similarly, PwC is the second most powerful brand in the world. But, most likely it has a much stronger presence and brand equity in countries with strong financial centers, such as the United States (New York), the Republic of Singapore (Singapore), and England (London) than in the rest of the world. These factors, relating to differences in culture, need to be studied and assessed by region and taken into account before any truly accurate accounting for brands can occur. Studies on the influence of location and culture on brand value are nearly non-existent today.

There are other intangible assets not currently valued or accounted for on the balance sheet in addition to brands. These include various important corporate strategies, such as the value of human capital, mission statements, vision, values, leadership development and corporate culture. All of these attributes help to add value to a company if and when implemented properly. Costs to create these programs are expensed. But, intangible assets created by successful implementation of these strategies are invaluable to many companies and are left off the financial statements. In the near future, the accounting profession may be faced with the decision of whether to capitalize these assets, keep them off the balance sheet and/or place them elsewhere in 10-Ks and other reporting documents.

9.0 Concluding Remarks

The accounting profession has traditionally ignored the issue of most intangible assets, treating them as an unsolved mystery. The existence of goodwill is acknowledged, but its composition is not dissected for true understanding. Accountants do not know what to do with intangible assets, many times just ignoring them, leaving them off balance sheets and income statements. Such is the case with brands. Brands are viewed as unidentifiable and not easily quantifiable, so they are swept under the rug. But, changes in the business world and views on marketing have altered consumers', corporations', and investors' views on the importance of brands. Accounting standards have failed to adjust, or at least make considerations, accordingly. It is time that accounting procedures align with the changing views and concerns of consumers, corporations and investors. Accounting professionals, FASB and IASB need to find a way to recognize brands within accounting standards.

10.0 Appendices

10.1 GAAP vs. IFRS Standards

GAAP¹⁸:

The cost of an internally generated intangible asset for the purpose of paragraph 24 is the sum of expenditure incurred from the date when the intangible asset first meets the recognition criteria in paragraphs 21, 22 and 57. Paragraph 71 prohibits reinstatement of expenditure previously recognised as an expense.

Expenditure on an intangible item shall be recognised as an expense when it is incurred unless:

- (a) it forms part of the cost of an intangible asset that meets the recognition criteria; or
- (b) the item is acquired in a business combination and cannot be recognised as an intangible asset. If this is the case, it forms part of the amount recognised as goodwill at the acquisition date (see IFRS 3).

IFRS¹⁹:

Internally generated intangible assets

Internally generated goodwill shall not be recognised as an asset.

No intangible asset arising from research (or from the research phase of an internal project) shall be recognised. Expenditure on research (or on the research phase of an internal project) shall be recognised as an expense when it is incurred.

An intangible asset arising from development (or from the development phase of an internal project) shall be recognised if, and only if, an entity can demonstrate all of the following:

- (a) the technical feasibility of completing the intangible asset so that it will be available for use or sale.
- (b) its intention to complete the intangible asset and use or sell it.
- (c) its ability to use or sell the intangible asset.
- (d) how the intangible asset will generate probable future economic benefits. Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset.
- (e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset.
- (f) its ability to measure reliably the expenditure attributable to the intangible asset during its development.

Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance shall not be recognised as intangible assets.

McGladrey Comparison²⁰:

	U.S. GAAP	IFRS
Relevant guidance	ASC 340-20, 350 and 985-20	IAS 38
Revaluations other than impairment considerations	Revaluations of intangible assets to fair value are prohibited.	Subsequent to their initial recognition, intangible assets (other than goodwill) may be revalued to fair value as an accounting policy election. However, because adoption of this election requires that fair value be determined by reference to an active market, it is rarely used.

	U.S. GAAP	IFRS
Internally developed intangible assets	<p>Costs of internally developing, maintaining or restoring intangible assets should be expensed as incurred when one or more of the following are true about the intangible asset: (a) it is not specifically identifiable, (b) it has an indeterminate life or (c) it is inherent in a continuing business or nonprofit activity and relates to an entity as a whole. Given these restrictive criteria, the recognition of internally developed intangible assets is rare and usually only seen in the areas of patents and trademarks.</p> <p>With limited exceptions, research and development costs are expensed as incurred. Two such exceptions relate to computer software:</p> <ul style="list-style-type: none"> • For computer software developed to be sold or otherwise marketed, development costs are capitalized after technological feasibility is established and until the product reaches general availability for sale. • For internal-use software, certain costs incurred during the application development stage should be capitalized. 	<p>Costs in the research phase are expensed as incurred. Costs in the development phase are capitalized if the entity can demonstrate all of the following:</p> <ul style="list-style-type: none"> • The technical feasibility of completing the intangible asset • The intention to complete the intangible asset • The ability to use or sell the intangible asset • How the intangible asset will generate probable future economic benefits (the entity should demonstrate the existence of a market or, if for internal use, the usefulness of the intangible asset) • The availability of adequate resources to complete the development and to use or sell the intangible asset • The ability to measure reliably the expenditures attributable to the intangible asset during its development <p>No software-specific guidance exists. As such, the general criteria are applied to software development costs to determine whether they should be capitalized or expensed.</p>

10.2 Forbes' Most Valuable Brands – 2014²¹

The World's Most Valuable Brands

Rank 🏆	Brand	Brand Value (\$bil)	1-Yr Value Change (%)	Brand Revenue (\$bil)	Company Advertising (\$mil)	Industry
1	 Apple	124.2	19	170.9	1,100	Technology
2	 Microsoft	63.0	11	86.7	2,300	Technology
3	 Google	56.6	19	51.4	2,848	Technology
4	 Coca-Cola	56.1	2	23.8	3,266	Beverages
5	 IBM	47.9	-5	99.8	1,294	Technology
6	 McDonald's	39.9	1	89.1	808	Restaurants
7	 General Electric	37.1	9	126.0	-	Diversified
8	 Samsung	35.0	19	209.6	3,818	Technology
9	 Toyota	31.3	22	182.2	4,200	Automotive
10	 Louis Vuitton	29.9	5	9.7	4,707	Luxury

10.3 2015 Top Global Brands: Brand Finance²²

Most Powerful Brands 2015:

Brand	Industry Group	Domicile	Brand Strength Index Score (/100)	Brand Rating 2015	Brand Value 2015 (USDm)
Lego	Toys	Denmark	93.4	AAA+	3,890
PWC	Pro. Services	US	91.8	AAA+	17,330
Red Bull	Beverages	Austria	91.1	AAA+	7,389
McKinsey	Pro. Services	US	90.1	AAA+	4,127
Unilever	Food	UK	90.1	AAA+	4,844
L'Oréal	Cosmetics	France	89.7	AAA+	12,480
Burberry	Apparel	UK	89.7	AAA+	4,612
Rolex	Apparel	Switzerland	89.7	AAA+	5,493
Ferrari	Automobiles	Italy	89.6	AAA+	4,747
Nike	Apparel	US	89.6	AAA+	24,118

Most Valuable Brands 2015:

Brand	Industry Group	Domicile	Brand Value 2015 (USDm)	Brand Value Change (%)	Brand Value 2014 (USDm)	Brand Rating 2015	Brand Rating 2014
Apple	Tech	US	128,303	23%	104,680	AAA	AAA
Samsung	Conglomerate	South Korea	81,716	4%	78,752	AAA-	AAA
Google	Tech	US	76,683	12%	68,620	AAA	AAA+
Microsoft	Tech	US	67,060	7%	62,783	AAA	AAA
Verizon	Telecoms	US	59,843	12%	53,466	AAA-	AAA-
AT&T	Telecoms	US	58,820	30%	45,410	AA+	AA
Amazon.com	Tech	US	56,124	24%	45,147	AAA-	AAA-
General Electric	Tech	US	48,019	-9%	52,533	AA+	AA+
China Mobile	Telecoms	China	47,916	50%	31,845	AAA-	AA+
Walmart	Retail	US	46,737	4%	44,779	AA+	AA+

Fastest Growing Brands 2015:

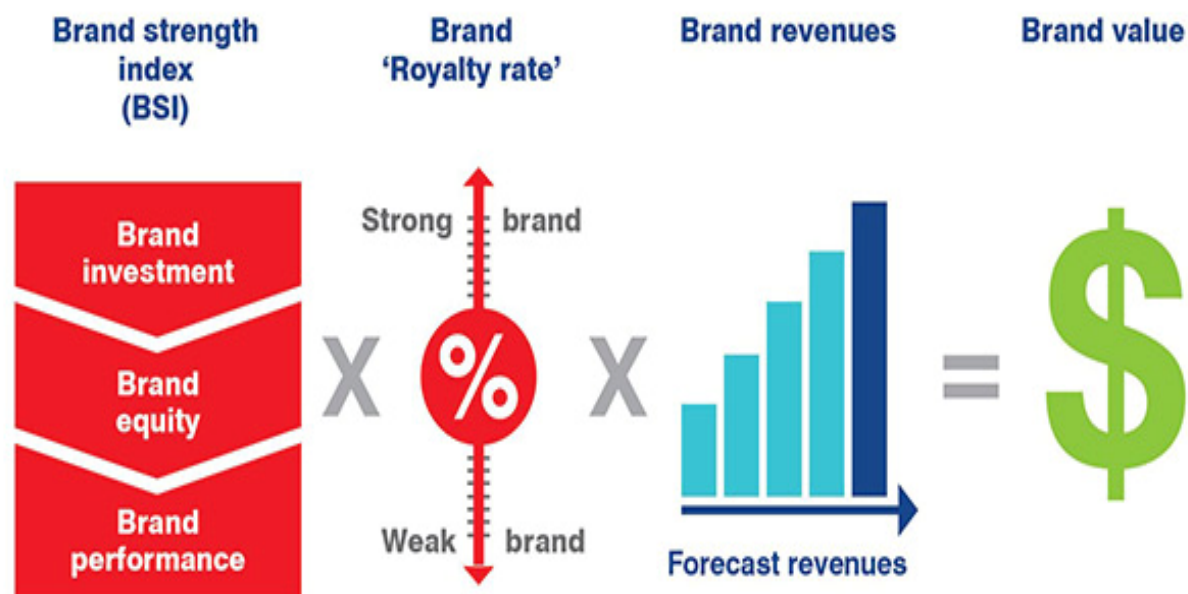
Brand	Industry Group	Domicile	Brand Value Change (%)	Brand Value 2015 (USDm)	Brand Value 2014 (USDm)	Brand Rating 2015	Brand Rating 2018
Twitter	Tech	US	185%	4,366	1,533	AAA-	AAA-
Baidu	Tech	China	161%	13,284	5,092	AA+	AA-
Facebook	Tech	US	146%	24,180	9,819	AAA-	AA+
Chipotle Mexican	Fast Food	US	124%	3,147	1,403	AA+	AA
Humana	Healthcare	US	99%	4,810	2,413	AA-	AA
priceline.com	Tech	US	97%	3,956	2,006	AA+	AA
Alibaba	Tech	China	90%	11,377	6,000	AA+	AA+
Lego	Toys	Denmark	69%	3,890	2,308	AAA+	AAA-
China Merchants Bank	Banks	China	65%	8,880	5,390	AAA-	AA
HCL	Tech	India	63%	3,148	1,925	AA	AA

10.4 Brand Finance: Methodology for Determining Brand Value²³

Royalty relief methodology

Brand Finance calculates brand value using the Royalty Relief methodology which determines the value a company would be willing to pay to license its brand as if it did not own it. This approach involves estimating the future revenue attributable to a brand and calculating a royalty rate that would be charged for the use of the brand. The steps in this process are as follows:

1. Calculate brand strength on a scale of 0 to 100 based using a balanced scorecard of a number of relevant attributes such as emotional connection, financial performance and sustainability, among others. This score is known as the Brand Strength Index.
2. Determine the royalty rate range for the respective brand sectors. This is done by reviewing comparable licensing agreements sourced from Brand Finance's extensive database of license agreements and other online databases.
3. Calculate royalty rate. The brand strength score is applied to the royalty rate range to arrive at a royalty rate. For example, if the royalty rate range in a brand's sector is 1-5% and a brand has a brand strength score of 75 out of 100, then an appropriate royalty rate for the use of this brand in the given sector will be 4%.
4. Determine brand specific revenues estimating a proportion of parent company revenues attributable to each specific brand and industry sector.
5. Determine forecast brand specific revenues using a function of historic revenues, equity analyst forecasts and economic growth rates.
6. Apply the royalty rate to the forecast revenues to derive the implied royalty charge for use of the brand.
7. The forecast royalties are discounted post tax to a net present value which represents current value of the future income attributable to the brand asset.



10.5 Apple Inc. 10-K (Year 2014): Consolidated Financial Statements²⁴

CONSOLIDATED BALANCE SHEETS

(In millions, except number of shares which are reflected in thousands and par value)

	September 27, 2014	September 28, 2013
ASSETS:		
Current assets:		
Cash and cash equivalents	\$ 13,844	\$ 14,259
Short-term marketable securities	11,233	26,287
Accounts receivable, less allowances of \$86 and \$99, respectively	17,460	13,102
Inventories	2,111	1,764
Deferred tax assets	4,318	3,453
Vendor non-trade receivables	9,759	7,539
Other current assets	9,806	6,882
Total current assets	68,531	73,286
Long-term marketable securities	130,162	106,215
Property, plant and equipment, net	20,624	16,597
Goodwill	4,616	1,577
Acquired intangible assets, net	4,142	4,179
Other assets	3,764	5,146
Total assets	<u>\$ 231,839</u>	<u>\$ 207,000</u>
LIABILITIES AND SHAREHOLDERS' EQUITY:		
Current liabilities:		
Accounts payable	\$ 30,196	\$ 22,367
Accrued expenses	18,453	13,856
Deferred revenue	8,491	7,435
Commercial paper	6,308	0
Total current liabilities	63,448	43,658
Deferred revenue – non-current	3,031	2,625
Long-term debt	28,987	16,960
Other non-current liabilities	24,826	20,208
Total liabilities	120,292	83,451
Commitments and contingencies		
Shareholders' equity:		
Common stock and additional paid-in capital, \$0.00001 per value; 12,600,000 shares authorized; 5,866,161 and 6,294,494 shares issued and outstanding, respectively	23,313	19,764
Retained earnings	87,152	104,256
Accumulated other comprehensive income/(loss)	1,082	(471)
Total shareholders' equity	111,547	123,549
Total liabilities and shareholders' equity	<u>\$ 231,839</u>	<u>\$ 207,000</u>

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In millions)

	Years ended		
	September 27, 2014	September 28, 2013	September 29, 2012
Net income	\$ 39,510	\$ 37,037	\$ 41,783
Other comprehensive income(loss):			
Change in foreign currency translation, net of tax effects of \$50, \$35 and \$13, respectively	(137)	(112)	(15)
Change in unrecognized gains(losses on derivative instruments:			
Change in fair value of derivatives, net of tax benefit(expense) of \$(297), \$(351) and \$73, respectively	1,390	522	(131)
Adjustment for net losses(gains), realized and included in net income, net of tax expense(benefit) of \$(36), \$255 and \$220, respectively	146	(458)	(369)
Total change in unrecognized gains(losses on derivative instruments, net of tax	1,536	94	(630)
Change in unrealized gains(losses on marketable securities:			
Change in fair value of marketable securities, net of tax benefit(expense) of \$(153), \$458 and \$(421), respectively	285	(791)	715
Adjustment for net losses(gains), realized and included in net income, net of tax expense(benefit) of \$71, \$62 and \$58, respectively	(134)	(131)	(114)
Total change in unrealized gains(losses on marketable securities, net of tax	151	(922)	601
Total other comprehensive income(loss)	1,563	(970)	66
Total comprehensive income	\$ 41,063	\$ 36,067	\$ 41,789

The following table summarizes the components of gross and net intangible asset balances as of September 27, 2014 and September 28, 2013 (in millions):

	2014			2013		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Definite-lived and amortizable acquired intangible assets	\$7,127	\$(3,085)	\$4,042	\$6,081	\$(2,002)	\$4,079
Indefinite-lived and non-amortizable acquired intangible assets	100	0	100	100	0	100
Total acquired intangible assets	<u>\$7,227</u>	<u>\$(3,085)</u>	<u>\$4,142</u>	<u>\$6,181</u>	<u>\$(2,002)</u>	<u>\$4,179</u>

Amortization expense related to acquired intangible assets was \$1.1 billion, \$960 million and \$605 million in 2014, 2013 and 2012, respectively. As of September 27, 2014, the remaining weighted-average amortization period for acquired intangible assets is 3.8 years. The expected annual amortization expense related to acquired intangible assets as of September 27, 2014, is as follows (in millions):

2015	\$ 1,204
2016	1,083
2017	825
2018	592
2019	175
Thereafter	163
Total	<u>\$ 4,042</u>

18 “Goodwill and other intangible assets – Key differences between U.S. GAAP and IFRSs” Deloitte, 2015.

19 “Technical Summary: IAS 38 Intangible Assets” IFRS, 2012.

20 “U.S. GAAP vs. IFRS: Intangible assets other than goodwill at-a-glance” R. Stuart, 2014.

21 “The World’s Most Valuable Brands” Forbes, 2014.

22 “Brand Finance announces the most valuable, powerful and fastest growing brands of 2015” Popsop, 2015.

23 “Explanation of the methodology” Brand Finance, 2015.

24 “Form 10-K: 2014” Apple, 2014.

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